

GAO

Report to the Chairman, Committee
on Finance, U.S. Senate

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DISTRESSED COMMUNITIES

Capital Investments Were Postponed in Texas as Local Economies Weakened



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4208

Human Resources Division

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February 6, 1991

The Honorable Lloyd Bentsen
Chairman, Committee on Finance
United States Senate

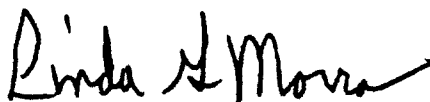
Dear Mr. Chairman:

This report provides information about the condition of basic public services in poorer communities in Texas. It examines these conditions in the context of changing federal-local fiscal relations due to declining federal aid and the loss of general revenue sharing. The report also examines local efforts to cope with fiscal problems and assesses whether state policies helped to offset these circumstances. This is our final case study on this subject. The other two were on fiscally distressed communities in California and New Jersey.

Copies of this report are being sent to other congressional committees and subcommittees and other interested parties.

Please contact me on (202) 275-1655 if you or your staff have any questions. Other major contributors are listed in appendix I.

Sincerely yours,



Linda G. Morra
Director, Human Services Policy and
Management Issues

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Executive Summary

Purpose

At the request of the Chairman of the Senate Committee on Finance, GAO examined the condition of local public services in poorer communities in light of recent declines in federal-local government aid and the expiration of the general revenue sharing (GRS) program. GAO visited communities in three states to (1) examine these conditions, (2) identify local responses to cope with the conditions, and (3) determine whether state policies and actions have helped to offset the negative impacts of losses in federal aid. This report is a case study of the city of Weslaco and Uvalde County, two of Texas's poorer communities.

Background

Local governments are the workhorses of domestic policy implementation. In our intergovernmental system, the federal government looks to them to provide basic public services, such as police, fire, and public works. It also depends on them to help fulfill national domestic objectives, such as combating drug abuse and protecting the environment. After increasing for nearly two decades, federal aid that supported these efforts declined in the 1980s. And the \$4.6 billion GRS program was terminated in 1986. Although a relatively small part of most local government budgets, GRS funds were important to poorer communities because—unlike most federal aid—they funded basic local public infrastructure, such as schools and roads. Additionally, poorer communities received more GRS funds per capita than the wealthier ones.

Results in Brief

Texas is recovering from the second of two economic slumps in the 1980s that were associated with problems in its oil and gas industry. Because Texas's economic problems affected all communities, the poorer communities GAO visited did not appear to lose economic ground relative to other Texas communities during the past decade.

Yet, fiscal conditions in poorer communities did worsen. These communities continued to be faced with greater-than-average service needs, but fewer resources of their own. Lack of state aid and the addition of new responsibilities mandated by the state also contributed to the fiscal problems of these communities, as did declining federal aid.

Local efforts to cope with fiscal problems associated with weak economies, state policies, and declining federal aid helped Weslaco and Uvalde to maintain their limited levels of most local services after revenue sharing funds ended. However, local strategies were insufficient to sustain existing levels of capital spending. Thus, both Weslaco and Uvalde postponed capital projects.

The expiration of GRS did not cause the fiscal or public service problems in Weslaco and Uvalde, but it contributed to them. Texas, like most states, did not replace GRS funds when the program expired in 1986. This is in keeping with Texas traditions of fiscal restraint and decentralized service delivery. Overall, state taxing, spending, and grant-in-aid policies made it more difficult for poorer communities, such as Weslaco and Uvalde, to meet their public service responsibilities.

Principal Findings

Federal Aid for Local Public Services Fell in the 1980s

When domestic problems are unresolved at lower levels of government, the federal government often intervenes through financial aid and regulation. Grant-in-aid spending in the 1960s and 1970s reflected increased federal involvement in local public affairs. However, in the 1980s federalism policies changed and budget priorities shifted, causing federal aid to municipalities and counties to decline substantially. These factors also led the Congress to end the GRS program in 1986 (see pp. 13-14).

Texas's Fiscal Policies Restrained Taxing and Spending

During the past two decades, Texas experienced wide swings in economic fortune, primarily due to the rise and fall of its oil and gas industry. Yet through good times and bad, Texas has remained a fiscally conservative state—as measured by patterns of taxing and spending (see pp. 20-25). During the economic boom of the 1970s and early 1980s, Texas took in more revenues than it spent as severance taxes¹ swelled to as much as 26 percent of total state taxes. Large surpluses were carried forward into later fiscal years, because the state did not spend excess funds. Thus it was able to reduce its reliance on sales taxes, which dropped from 70 percent of total tax revenues in 1972 to 63 percent in 1982. Texas has no income tax (see pp. 22-24).

In 1982, a national recession coupled with the concomitant decline in the oil and gas industry dealt the state a powerful fiscal blow. In 1986, state finances suffered a second setback when the price of oil worldwide again decreased dramatically. While the state took a number of remedial actions to avoid tax increases, its sales tax base was eventually broadened; rates were raised and user fees increased. These measures failed

¹These taxes are imposed on the value or quantity of materials, such as oil, gas, and other natural resources, removed from the land or water. Thirty-three states levy severance taxes, but they are a minor revenue source in most states.

to fully offset revenue losses, causing Texas's tax effort² to decline by 15 percent between 1978 and 1987—the second largest decline among the 50 states. In 1988, Texas state revenues per capita were 74 percent of the U.S. average. Only four states ranked lower (see pp. 22-23).

Fiscal restraint is also reflected in state expenditures, which in 1988, averaged \$1,763 per capita, nationwide. In contrast, Texas spent less than \$1,227—the least among the 50 states. In no category of spending that GAO examined was Texas in the top half of the distribution of states. Texas's highest ranking came in higher education, where it placed 27th. It ranked 32nd in highway spending, 34th in hospitals, 36th in education, 45th in police, and 48th in public welfare (see p. 25).

Local Governments in Texas Finance a Greater Share of Public Services Than in Most States

Texas has heavily decentralized public service delivery, whereby localities finance a large share of total state-local spending. State aid patterns underscore the extent to which Texas localities are on their own in this respect. In 1988, states allocated an average of \$592 per capita in state-local aid. Texas provided \$385—less than 65 percent of the national average. Of this amount, school districts received 94 percent; counties, 4 percent; and municipalities, about 2 percent. These are in sharp contrast to the national averages of 53, 24, and 22 percent, respectively (see pp. 26-27).

Texas localities became even more fiscally self-reliant in the 1980s because federal aid declined from 15 percent of total local government revenues to less than 5 percent, while state aid to localities grew by less than 1 percent (see pp. 28-29). Consistent with these traditions, Texas did not replace GRS funds when they lapsed in 1986. Nor has the state taken other steps to lessen the fiscal problems of its poorer communities.

GAO has found that general-purpose state aid targeted to poorer communities is not a solution to the demographic, social, or economic factors that underlie fiscal distress in these communities. Yet past work also shows that it can help lessen public service problems.³ Without such a program, Weslaco and Uvalde (and communities like them) must cope with their local public service problems on their own (see pp. 31-35).

²Defined as revenues raised per \$100 of personal income.

³Distressed Communities: Public Services Declined in New Jersey Despite Targeted State Aid (GAO/HRD-90-96, July 9, 1990).

Poorer Communities Remain at Greater Risk

Texas has some of the wealthiest and poorest communities in the nation. While poorer ones did not lose substantial economic ground to wealthier ones in a period of statewide economic stress, the gap between poorer communities, such as Weslaco and Uvalde, and more affluent ones remained high compared to most other states. Thus, Weslaco and Uvalde continued to face substantially greater problems due to their higher service needs and fewer resources of their own (see pp. 30-33).

Communities Relied Mostly on Postponing Capital Investments

Local governments have a number of coping strategies to choose from when public service needs exceed revenues. These strategies include management improvements and revenue actions (e.g., tax and user fee increases, drawing down reserves, and incurring debt). They also include reductions in program spending and postponement of capital investments. While the first two strategies help to maintain public services, the latter two reduce them. Growing service demands, troubled economies, conservative state fiscal policies, and declining federal aid caused both communities to implement three of the four strategies before 1986, and they continued to use them after GRS ended (see pp. 36-41).

Weslaco and Uvalde made management improvements in administration and program operations to stave off cuts in public services. However, the approach that these communities relied on most was to increase revenues, primarily by raising taxes. Weslaco also increased user fees and significantly increased its borrowing, something Uvalde is exploring as a means of meeting its growing infrastructure problems. While these actions have enabled Weslaco and Uvalde to maintain most public services at low levels, they were insufficient to sustain current levels of capital spending. As a result, both communities have postponed some capital investments since GRS's termination (see pp. 38-41).

Recommendations

GAO is making no recommendations.

Agency Comments

GAO discussed the contents of this report with Texas state and local officials and incorporated their comments where appropriate.

Contents

Executive Summary		2
Chapter 1		10
Introduction	Local Governments Are Major Providers of Basic Public Services	10
	After Rising for Two Decades, Federal Aid to Local Governments Has Fallen	11
	The Rise and Demise of GRS	13
	GRS Provided Funds for Local Public Services, Yet Measuring Its Impacts Is Difficult	14
	GRS Losses Are Especially Hard for Poorer Communities to Absorb	15
	State-Local Strategies to Cope With Needs-Revenues Imbalances	16
	Objectives, Scope, and Methodology	18
Chapter 2		20
Weak Economies and State Policies Strained Local Finances and Capital Investment in Poorer Texas Communities	Revenue and Expenditure Trends Reflect Economic Fortunes and State Policies	20
	Localities Must Finance Public Services on Their Own	26
	Texas Gives Localities Taxing Authority Comparable to Most States	30
	The Mismatch of Needs and Resources in Weslaco and Uvalde Make It Especially Hard to Provide Public Services	30
	Revenue and Expenditure Trends Indicate Weslaco's and Uvalde's Problems	33
	GRS an Important Funding Source for Capital Investments in Poorer Communities	35
Chapter 3		36
Actions Taken by Poorer Communities Helped Maintain Public Services, but Capital Investments Were Postponed	Management Strategies Sometimes Helped to Maintain Services With Less Revenue	36
	Raising Revenues Was the Primary Strategy Used	38
	Capital Investments Were Postponed	40
	Conclusions	41

Appendix	Appendix I: Major Contributors to This Report	42
Tables	Table 1.1: Per Capita Federal and State Aid to Local Governments (In Constant 1982 Dollars)	13
	Table 2.1: GSP and Population Trends, Texas and the United States	21
	Table 2.2: Selected Socioeconomic Indicators, Uvalde and Weslaco	32
	Table 2.3: Expenditure and Revenue Trends for Selected Items, Weslaco and Uvalde Percent Changes in Constant Dollar Per Capita Amounts (Fiscal Year 1977 to 1987)	34
Figures	Figure 1.1: Percentage of Total Direct Expenditures for Selected Public Services, by Type of Government (Fiscal Year 1988)	11
	Figure 1.2: Trends in Per Capita Federal Aid to Local Governments (1974-88)	12
	Figure 1.3: Number of Counties Above or Below the National Per Capita Mean Income in 1978 and 1988	16
	Figure 1.4: Case Study Communities in Texas	19
	Figure 2.1: Trends in Real Gross State Product Per Capita, Texas and the United States	22
	Figure 2.2: Per Capita State Aid to All Local Governments, Texas and the United States (Fiscal Year 1988)	26
	Figure 2.3: Percent of State Aid to Local Governments, Texas and the United States (Fiscal Year 1988)	27
	Figure 2.4: Local Government Share of Total State and Local Spending, Texas and the United States (Fiscal Year 1988)	28
	Figure 2.5: Revenue Sources of Texas Counties and Municipalities as a Percentage of Total Revenues (Fiscal Years 1978-88)	29
	Figure 2.6: Trends in PCPI of Wealthier and Poorer Texas Counties as a Percentage of U.S. PCPI	33

Contents

Abbreviations

GDP	gross domestic product
GNP	gross national product
GRS	general revenue sharing
GSP	gross state product
PCPI	per capita personal income

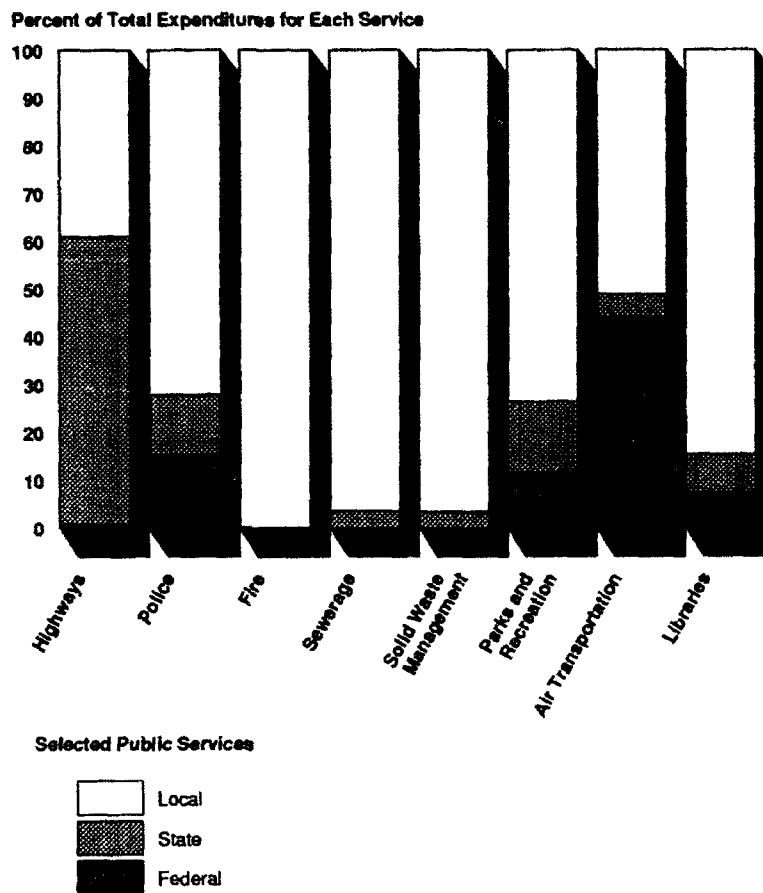
Introduction

Local governments are the workhorses of domestic policy. However, they do not carry out their responsibilities alone. In our federal system of government, responsibilities are shared, as well as divided. From the 1960s through the 1970s, the federal government increased its activity in local public affairs, expanding the number and scope of federal grants-in-aid programs and increasing grant funding. As a result, general-purpose local governments, notably counties and municipalities, became more dependent on the federal government. In the 1980s, this trend reversed as federal aid to local governments decreased substantially. In particular, the Congress repealed the \$4.6 billion-per-year general revenue sharing (GRS) program. All local governments have had to adjust to this shrinking support. However, poorer communities have higher public service needs but fewer resources of their own, circumstances that present them with greater difficulty in absorbing federal aid cuts.

Local Governments Are Major Providers of Basic Public Services

Apart from administering a few programs, such as Social Security, the federal government plays a minor direct role in providing domestic public services. Instead, the majority of these programs are implemented through a partnership among federal, state, and local governments. In this partnership, localities are the workhorses. In 1988, local governments led the federal and state governments in direct spending for police and fire protection, sewerage, solid waste management, parks and recreation, air transportation, libraries, and general public buildings (see fig. 1.1).

Figure 1.1: Percentage of Total Direct Expenditures for Selected Public Services, by Type of Government
(Fiscal Year 1988)



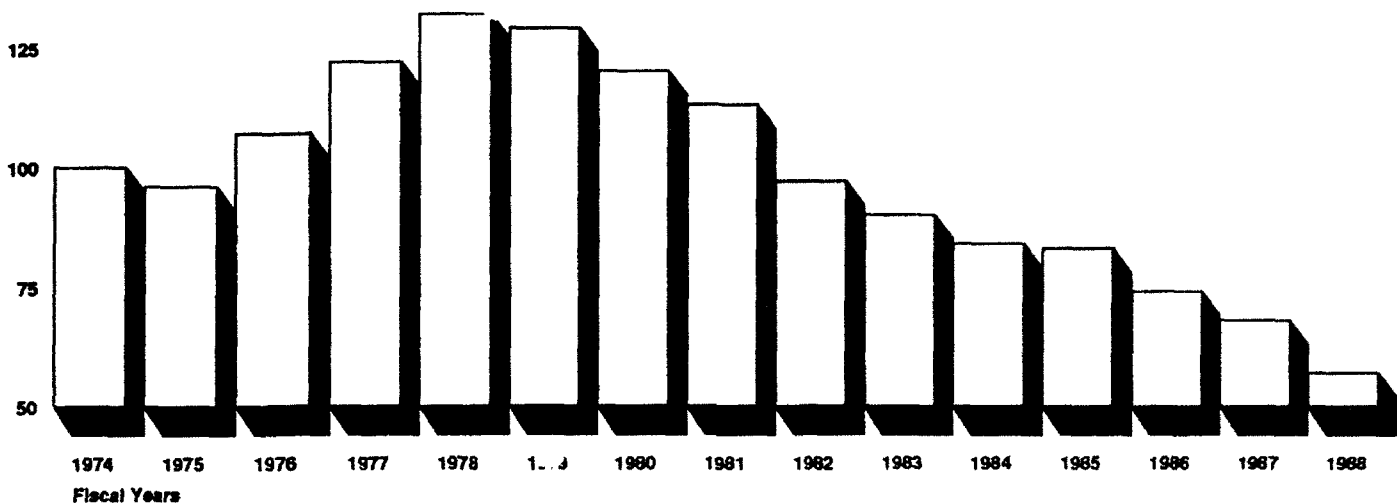
Source: Bureau of the Census, *Government Finances in 1987-88*

After Rising for Two Decades, Federal Aid to Local Governments Has Fallen

American public opinion strongly favors keeping the provision of public services close to the grassroots. Yet this opinion has also supported federal financial and regulatory intervention, especially when problems are unresolved at lower levels of government. Problems unresolved at these levels have often spurred new federal initiatives. Grants-in-aid spending reflected these increased federal commitments to localities as aid rose steadily until 1978, as figure 1.2 shows.

Figure 1.2: Trends in Per Capita Federal Aid to Local Governments (1974-88)

150 Constant 1982 Dollars Per Capita



Sources: The Advisory Commission on Intergovernmental Relations, Bureau of Economic Analysis, and Bureau of the Census.

In the 1980s, changing federalism policies favored an enhanced role for states in the development and implementation of intergovernmental programs. These programs included some that had previously been federal-local.¹ Additionally, federal budget priorities favored defense and entitlement program spending over programs for housing, economic development, and infrastructure. Since the latter kinds of programs were predominantly federal-local, aid to localities declined between 1978 and 1988, when measured in constant dollars. As a percentage share of total municipal revenues, federal assistance dropped 62 percent from 1980 to 1988. As a percentage share of total county revenues, federal aid dropped 73 percent over the same period. As table 1.1 suggests, GRS was the most visible, but by no means the only, program cut.²

¹Block Grants: Overview of Experience to Date and Emerging Issues (GAO/HRD-85-46, Apr. 3, 1985).

²The GRS program was enacted as the State and Local Fiscal Assistance Act of 1972 and amended in 1976, 1980, and 1983. It terminated for states in 1980 and local governments in 1986.

Table 1.1: Per Capita Federal and State Aid to Local Governments (In Constant 1982 Dollars)

	Fiscal year		Percentage change
	1980	1988	
Direct federal aid to local governments			
Total	\$120.07	\$56.68	-53
Public welfare	1.36	1.54	13
Education	9.49	5.08	-46
General revenue sharing	25.94	0	-100
Highways	0.68	1.18	74
Housing and community development	20.97	24.38	16
Health and hospitals	1.16	1.12	-3
Other	60.47	23.37	-61
State aid to local governments*			
Total	\$461.80	\$481.93	4
Public welfare	50.69	54.10	7
Education	298.25	312.10	5
Highways	23.51	22.40	-5
Health and hospitals	11.87	14.32	21
Other	77.48	79.02	2

^aMay include federal aid passed through to localities.

Sources: Bureau of the Census and Bureau of Economic Analysis.

The Rise and Demise of GRS

GRS was originally introduced as the fiscal centerpiece of the Nixon administration's "New Federalism." This sweeping presidential initiative would have nationalized welfare through the Family Assistance Plan. It would have consolidated 129 categorical grants (totaling \$11.3 billion) into six decentralized block grants. And it would have created a \$5 billion program of unrestricted intergovernmental aid—GRS—distributed to virtually every state and local government in the United States.

President Nixon advanced this package of general and special revenue sharing proposals during a period in which many prominent economists predicted that the federal government would soon experience large budget surpluses. However, sharing excess federal revenues was not the administration's principal aim. Rather, as the President described his intentions in the 1971 State of the Union Address:

"The time has come to reverse the flow of power and resources from the states and communities to Washington, and start power and resources flowing back from

Washington to the states and communities, and, more importantly, to the people—all across America.”

GRS served the aim of decentralization well because recipients were given the broadest possible latitude to determine program spending.

Despite early congressional reservations, GRS was eventually enacted as the State and Local Fiscal Assistance Act of 1972. Over its 14-year life, GRS provided over \$78 billion to 39,000 state and local governments. Populous states, such as California, received as much as \$8.6 billion in total aid, while rural states, such as Wyoming, received as little as \$164 million. As intended, GRS proved to be the least cumbersome and among the most popular of all federal aid programs, from the perspective of recipients.

Although President Reagan shared President Nixon’s decentralization goals, he gave higher priority to federal tax cuts and reducing domestic spending than to sharing federal tax revenues with state and local governments. Moreover, by 1985, mounting federal deficits convinced the Congress that GRS—a nearly \$5 billion line item in the federal budget—was no longer viable. Neither the House nor the Senate fiscal year 1986 budget resolution contained GRS funding, and the funding ended on schedule in 1986.

GRS Provided Funds for Local Public Services, Yet Measuring Its Impacts Is Difficult

Virtually all evaluations of the GRS program concur that its funds were used predominantly to support local public services and capital investments. For example, according to official use reports submitted to the Department of the Treasury, GRS primarily helped to maintain or improve local public services. A Brookings Institution monitoring study identified county spending on public transportation (i.e., roads, highways, and mass transit subsidies) as the program category most significantly affected by GRS. Public safety (i.e., police, fire, and corrections) ranked next among identifiable spending categories, followed by capital spending in primary and secondary education. Among municipalities, public safety spending was most affected. Public transportation and environmental protection (i.e., sewerage, sanitation, and water supply) ranked next. Because funds supported essential public services and because poorer communities received relatively more funds per capita than their wealthier neighbors, GRS was a particularly valuable resource for fiscally distressed communities.

Nevertheless, precisely identifying the effects of GRS on spending priorities in the communities we visited was difficult because GRS funds are unrestricted.³ That is, GRS funds could be spent for any purpose that the local government could legally spend its own revenues for, making GRS dollars virtually indistinguishable from local revenues. We can, therefore, report the impacts of GRS funds on local public services as described by local officials in the communities we visited. We cannot, however, link the loss of GRS dollars to public service problems with precision. This does not mean that general conclusions about the impact of the program's expiration cannot be drawn. GRS losses were one factor contributing to general fiscal pressures that caused the public service problems we observed.

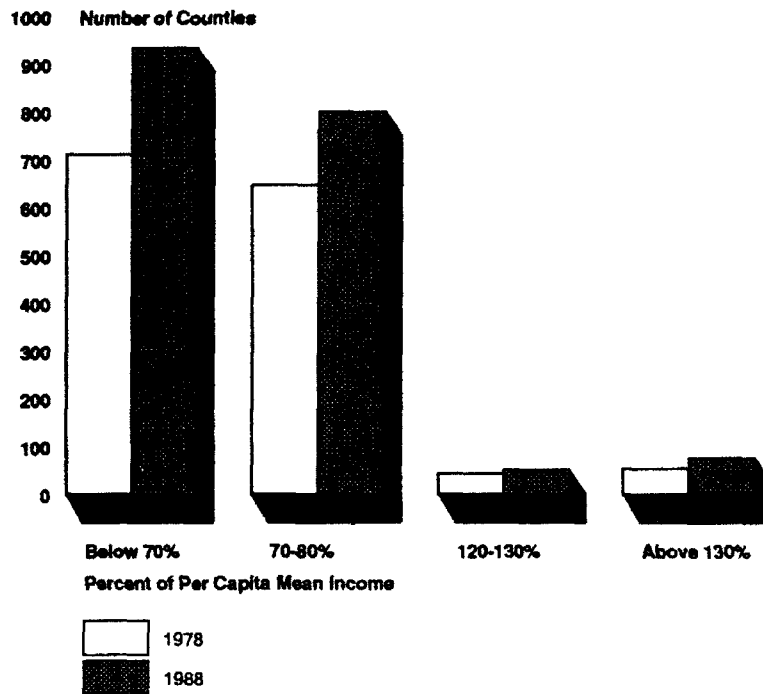
GRS Losses Are Especially Hard for Poorer Communities to Absorb

Fiscal disparities characterize the situation in which different communities must tax their citizens and businesses at different levels to obtain similar public services. This occurs because neither fiscal circumstances nor the need for public services is uniform across communities. Such disparities make it harder for poorer communities to provide adequate public services on their own. Often communities with the greatest needs have the least resources to meet them. In poorer communities, even very high tax rates can fail to produce revenues sufficient to meet service needs. Yet when tax rates are already high relative to surrounding localities, raising them is likely to exacerbate existing problems of middle-class flight and declining business investment.

Nationwide, these kinds of imbalances between needs and revenues grew over the past decade. The number of counties where per capita income was below 70 percent of the national average rose from 711 to 934 between 1978 and 1988, a 31-percent increase. (See fig. 1.3.) In contrast, the number of counties where per capita income was above 130 percent of the national average rose from 54 to 76, a 41-percent increase. Moreover, populations have become larger in both wealthier and poorer counties in the United States. A smaller fraction of the U.S. population lived in middle-income counties in 1988 than in 1978.

³See, for example, Catherine Lovell, "Measuring the Effects of General Revenue Sharing: Some Alternative Strategies Applied to 97 Cities," in *Revenue Sharing*, David Caputo, ed. (Lexington, Mass.: D.C. Heath and Co., 1976), pp. 49-65.

Figure 1.3: Number of Counties Above or Below the National Per Capita Mean Income in 1978 and 1988



Source: Bureau of Economic Analysis.

State-Local Strategies to Cope With Needs-Revenues Imbalances

Like all governments, poor communities can choose from a variety of coping strategies when public service needs exceed available resources. Management improvements that deliver services more efficiently and/or effectively help to maintain services with less revenue. Raising taxes is another option. In poorer communities, where tax bases are weak, this strategy is not without substantial costs to residents. It also can promote middle-class flight and exacerbate declining business investment. Other strategies—especially delays in infrastructure repair or construction or budget cuts in program staff or services—produce a decline in public services.

States can help poorer communities when local needs exceed local revenues. Because of their superior constitutional positions, states have always been an important factor shaping local government. To varying degrees, states dictate local government structures and services, control local revenue raising, and direct administration of local programs. States also have the power to affect equity, effectiveness, efficiency, and accountability in local government institutions and public services.

Some state policies make it more difficult for communities to meet their basic public service responsibilities. Tax and expenditure limitations constrain service delivery. Unreimbursed state-mandated programs may also cause problems. Other state policies can help. State assumption of services lifts responsibility from the shoulders of local governments, including poorer communities. Through mandate reimbursement, states can compensate localities for the costs of oversight and administration of state regulations. Targeting reimbursements can reduce certain mandated costs that fall heavily on poorer communities.⁴

Most directly, states can help poorer communities meet their public service responsibilities as well as lessen the negative impacts of declining federal aid through their grant-in-aid systems. During the 1980s, when federal aid decreased, state aid to local governments increased, from an average \$462 to \$482 per capita (constant 1982 dollars). However, most of this growth was in education, health, and criminal justice programs—areas in which either federal aid was not as substantial as state aid (e.g., education) or it did not decline as much (e.g., health). Meanwhile, local revenue raising outpaced aggregate increases in state aid during the 1980s. Thus, in 1980, states provided 33 cents for every dollar of own-source municipal revenues. In 1988, this figure was 29 cents. Similarly, in 1980 states provided 64 cents for every dollar of county own-source revenues. Yet, in 1988 this figure was 51 cents. Other research we have done shows that, by and large, general state aid to local governments has not been targeted to poorer communities.⁵ Because aid is predominantly distributed on a per capita or return-to-place-of-origin basis,⁶ poorer communities continued to receive less aid than their wealthier or larger neighbors during this period.

⁴Legislative Mandates: State Experiences Offer Insights for Federal Action (GAO/HRD-88-75, Sept. 27, 1988).

⁵Fiscally Distressed Communities: State Grant Targeting Provides Limited Help (GAO/HRD-90-69, May 13, 1990).

⁶Transfers of state funds to local governments on a return-to-place-of-origin basis are also called "distributions on a source basis" or "shared taxes," although the latter term is sometimes used more narrowly in reference to specific portions of state taxes distributed back to the local government where the taxes were collected.

Objectives, Scope, and Methodology

Our objectives in reporting on public services in poorer communities were to determine

- the condition of local public services in light of reductions in direct federal assistance to local governments and the expiration of GRS
- the range of local government responses to these conditions, and
- whether state policies and actions have helped to offset public service problems.

To accomplish our first objective we reviewed trends in direct federal-local aid and drew from our earlier research on trends in the intergovernmental system. We then visited poorer communities in California, New Jersey, and Texas. We collected data on public services from local sources and state documents, and we interviewed local officials to gain insights into local trends and conditions.

To accomplish our second objective we examined local budgets and other relevant financial documents. We also spoke with public officials and others about the strategies that communities used to cope with their fiscal stress and declining federal aid.

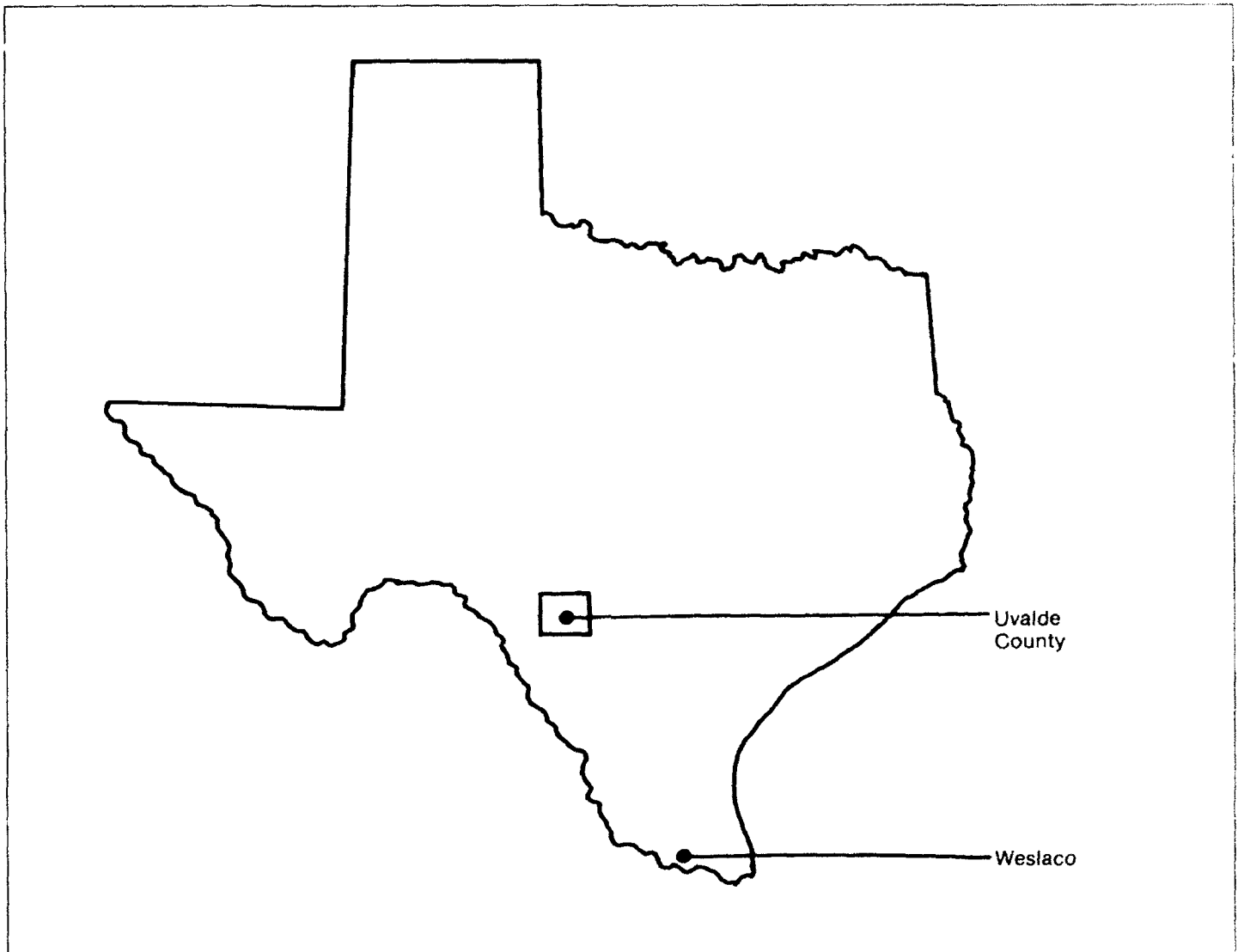
To accomplish our third objective we examined state aid and other state policies to determine whether states that we visited had replaced GRS or otherwise taken steps to lessen the negative impacts of declining federal-local aid and the expiration of GRS.

As stated, we visited communities in California, New Jersey, and Texas. We selected states and chose field sites that were different along dimensions of state-local relations that we believed would help to explain variation in local public service conditions. Differences we considered included variations in kinds of services provided at state versus local levels, state mandating policies, and patterns of state aid to local governments. Within states, we selected communities that were among the more fiscally distressed and that had higher-than-average service needs, as indicated by socioeconomic and other statistical indicators.

This case study is on Weslaco and Uvalde, two of Texas's more fiscally distressed communities. (See fig. 1.4.) We also visited wealthier communities in Texas. These visits provided a better basis for assessing conditions in poorer communities. However, because wealthier communities were not the focus of our work, we did not include information on them in our report.

We carried out our work between September 1988 and July 1990 in accordance with generally accepted government auditing standards.

Figure 1.4: Case Study Communities in Texas



Weak Economies and State Policies Strained Local Finances and Capital Investment in Poorer Texas Communities

Texas is recovering from an economic slump that has adversely affected the state as well as its local governments. While few communities escaped these economic circumstances unscathed, poorer ones faced greater problems due to higher service needs and fewer resources of their own. Texas's weak economy also strained state finances during a period in which court decisions mandated higher levels of spending for education, health, and corrections. Nevertheless, the state did not increase its tax effort. And, in keeping with historically conservative fiscal policies, Texas passed some of these court-imposed costs onto local governments.

During a period in which local service costs increased and intergovernmental aid declined, both Weslaco and Uvalde used revenue sharing funds primarily to fund road construction and capital improvements. Hence, the program's termination did not directly cause spending on most local services to decline below their already-low levels. However, the loss contributed to mounting budget pressures, reduced capital spending, and increased debt.

Revenue and Expenditure Trends Reflect Economic Fortunes and State Policies

Over the past two decades, Texas has experienced wide swings in economic fortune, primarily due to the rise and fall of its oil and gas industry. During good economic times and bad, Texas has remained a fiscally conservative state, as reflected in patterns of taxing and spending. Texas localities also were affected by the changes in economic fortune. In contrast to the state, however, localities increased their tax effort in the face of both declining revenues and increased service responsibilities.

Economic Fortunes Swung From Boom to Bust

Sharp contrasts in Texas economic conditions that affected the state and its local governments are reflected in gross state product (GSP)¹ and county per capita personal income (PCPI) statistics. Between 1972 and 1981, the national GSP increased 2.5 times, while the Texas GSP increased 3.7. On the other hand, between 1981 and 1986, the national GSP increased 40 percent, while in Texas it increased 25 percent. The magnitude of this turnaround in economic fortunes is illustrated by the fact that the Texas GSP increased at an average annual rate of 15.7 percent per year between 1972 and 1981, but dropped to 4.5 percent between

¹GSP is the gross market value of the goods and services attributable to labor and property located in a state. It is the state counterpart of the nation's gross domestic product (GDP). This in turn, equals gross national product (GNP) less net inflow of labor and property incomes from abroad.

Chapter 2
Weak Economies and State Policies Strained
Local Finances and Capital Investment in
Poorer Texas Communities

1981 and 1986, as table 2.1 shows. As figure 2.1 shows, the Texas GSP per capita (in constant 1982 dollars) grew faster than the U.S. GSP during 1972-1981, peaked in 1981, and grew slower than it during 1981-86.

Table 2.1: GSP and Population Trends, Texas and the United States

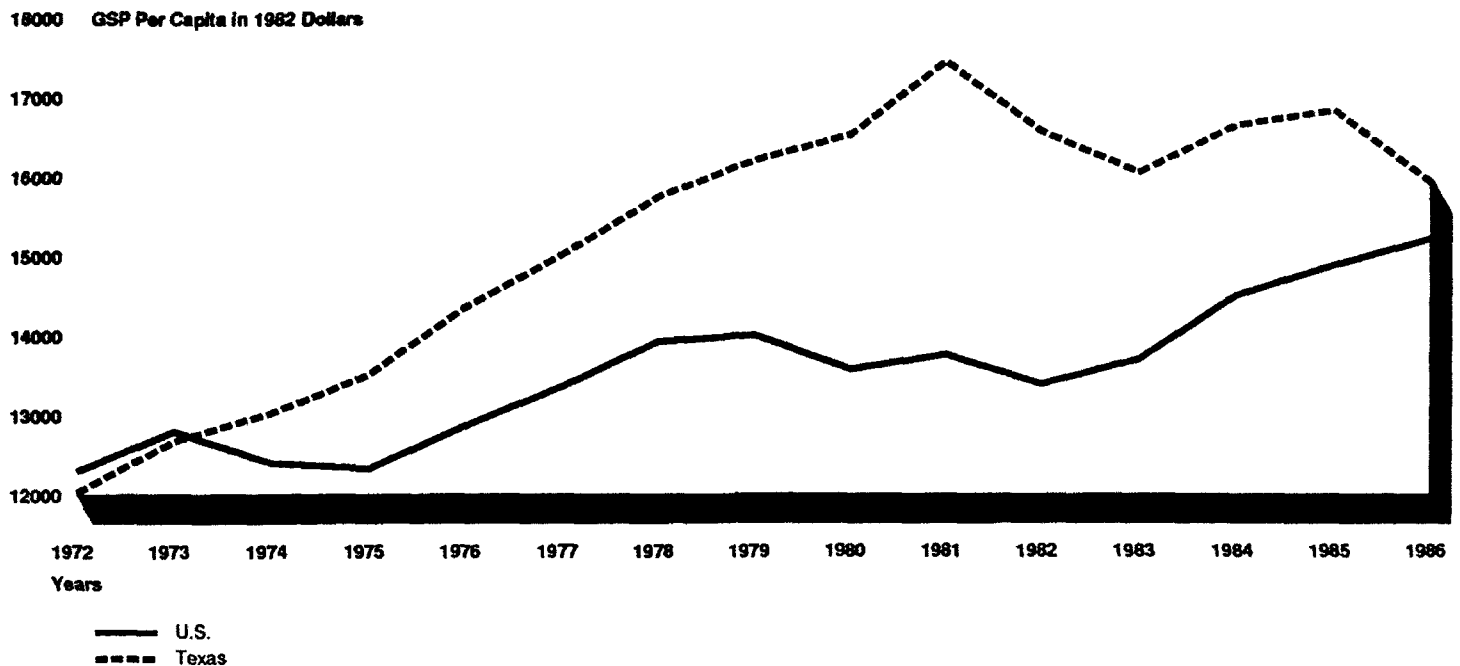
Dollars and population in millions

Dollars and population in millions				Average annual rate of change (percent)	
	1972	1981	1986	1972- 81	1981- 86
All States					
GSP	\$1,196.0	\$2,986.9	\$4,191.7	10.7	7.0
Population	209.3	229.6	241.1	1.0	1.0
Real GSP per capita ^a	12,290.0	13,750.0	15,210.0	1.3	2.0
Texas					
GSP	\$65.7	\$243.5	\$303.5	15.7	4.5
Population	11.8	14.8	16.7	2.6	2.5
Real GSP per capita ^a	12,024.0	17,438.0	15,921.0	4.2	-1.8
Exhibit					
GNP deflator 1982 = 100	46.5	94.6	114.3	8.2	3.9

^aConstant 1982 dollar amounts calculated using GNP deflator.

Source: Bureau of Economic Analysis.

Figure 2.1: Trends in Real Gross State Product Per Capita, Texas and the United States



Source: Bureau of Economic Analysis.

Texas localities were similarly affected by the state's boom and bust economy. Reflecting these, between 1973 and 1981 Texas PCPI grew substantially faster than the U.S. average, from \$9,381 in 1973 to \$11,759 in 1981 (constant 1982 dollars). But, PCPI remained nearly constant between 1981 and 1988, while U.S. PCPI grew more rapidly than it had during 1973-81.

Revenue Trends Shifted With Economic Tides

From the perspective of state finances, economic problems have posed particular difficulties for Texas because it—one of four states without either a corporate or individual income tax—traditionally has depended on sales and severance taxes² to a much greater extent than most states. Trends in severance taxes were especially important. In terms of per capita severance taxes levied, Texas ranked 8th in 1982—at \$155 per capita. During the economic boom of the 1970s and early 1980s, Texas

²These taxes are imposed on the value or quantity of materials, such as oil, gas, or other natural resources, removed from the land or water. Thirty-three states levy severance taxes, but they are a minor revenue source in most states.

oil and gas severance taxes accounted for as much as 26 percent of total state taxes. In this period, the state ran large surpluses and carried them forward into succeeding fiscal years. At the same time, Texas was able to reduce its reliance on sales taxes. Expressed as a share of total tax revenues, these dropped from 70 percent in 1972 to 63 percent in 1982.³

In 1982, the state's finances began to weaken, the result of falling oil and gas prices, the devaluation of the Mexican peso, and a generally declining national economy. Again in 1986, dramatic worldwide declines in oil and gas prices seriously affected Texas severance tax collections. Although in 1988 Texas still ranked 9th nationwide in these collections, severance taxes were producing far less revenue. By then levies had dropped over \$90—to \$63 per capita. As a consequence, severance tax revenues declined to less than 8 percent of total tax revenues by this time. Concomitantly, sales taxes rose to 77 percent.

The resulting fiscal squeeze first caused Texas to take a number of short-term and one-time actions. For example, the legislature spent available fund surpluses. It sped up various tax due dates, and it reduced its own contributions to the employees' retirement system. Ultimately, however, projected budgetary shortfalls caused the state to take longer-term actions to raise revenues from its primary tax source—by broadening the sales tax base and increasing the rate. At the same time user fees were increased at the state level, rising from 8.4 percent of total own-source general revenues in 1982 to 9.0 percent in 1988.

Despite the volatility of certain revenues, Texas has remained one of the very lowest-tax states. Overall, in 1978 Texas ranked 45th among the 50 states in tax revenues per capita, at 79 percent of the U.S. average. In 1988, the picture was little different. Texas's state tax revenues per capita were at 74 percent of the U.S. average. That year, only four states levied lower per capita state taxes.⁴

From the perspective of local government finances, Texas's economic problems were most significant vis a vis their effect on property tax revenues. Locally, these taxes decreased in the face of declining property values. And the proportional tax burden shifted more to residential

³Based on Census data including general and selective sales taxes.

⁴Looking at tax revenues as a share of PCPI, the picture is much the same. At \$62 per \$1,000 of personal income, Texas ranked 45 of 50 states in total tax revenues in 1978. In 1988, it ranked 46th, at \$58 per \$1,000.

property from commercial property as the latter property values declined.

Texas localities are especially vulnerable to the above-described shift in the incidence of local property taxes because these taxes are more important to these localities than to most local governments. They account for nearly 10 percent more of total local taxes in Texas than they do nationwide—83 percent (1988) compared to a national average of about 74 percent.⁵ A troubled economy in Texas caused local property tax revenue shortfalls primarily because of declining property values, especially those of gas- and oil-producing properties. Nationwide data on oil and gas property valuation are not available. However, in 1986, the percentage of gross assessed valuation categorized as residential was 61 nationwide and 47 in Texas. Texas's low proportion of residential valuation (ranking 46th of 50 states) indicates the importance of commercial, industrial, and other nonresidential uses in its local property tax bases.

Declining nonresidential property values also caused an increase in the proportion of local property taxes paid by owners of residential real estate. As the Texas Tax Study points out, public support for increased taxes to support local services is not strong.⁶ This makes it difficult to maintain revenues sufficient to fund both mandated services and local priority capital projects.

Localities Increased Their Tax Effort

Texas state and local governments responded to their fiscal circumstances very differently. This contrast is most clearly reflected in comparisons of trends in state versus local tax efforts.⁷ In keeping with conservative fiscal traditions, the state experienced a nearly 15-percent decline in its tax effort between 1978 and 1987 (as measured by changes in tax revenues per \$100 of personal income). When compared to other states' tax trends over the same period, Texas ranked nearly at the bottom—49th of 50—expressed in terms of increases in tax effort. In contrast, local governments responded to declining tax revenues by

⁵Figures for 1988 differ moderately from past statistics. For example, in 1978 property taxes accounted for 85 percent of total taxes among Texas localities, compared to a national average of 80.

⁶Increasing the tax burden on local voters, in effect, raises the cost of current services. In public finance terms, the tax price of a given service level has risen. In such circumstances, all other things being equal, voters demand less services in the face of higher costs.

⁷Tax effort is defined as the degree to which governmental units utilize their potential ability to raise tax revenues. Their ability to do this is commonly measured by income. For this report, we measure tax effort as total tax revenues as a percentage of personal income.

increasing their own tax effort substantially. For example, during the 1978-87 period, Texas localities increased their effort by nearly 19 percent—the 3rd highest increase among the 50 states.

State Spending Was Constrained in Good Economic Times and Bad

Fiscal restraint is also reflected in Texas state expenditure trends. Nationwide, state general expenditures were \$827 per capita in 1978. Texas spent \$620 per capita and ranked 49th. In 1988 these expenditures were \$1,763 per capita, nationwide. In 1988, Texas spent \$1,227—the least nationwide. In no category of spending examined by the Census Bureau did Texas rank in the top half of the states. In fact, its highest ranking came in higher education—where it placed 27th. It placed 32nd in highway spending, 34th in hospitals, 36th in education, 45th in police, and 48th in public welfare.

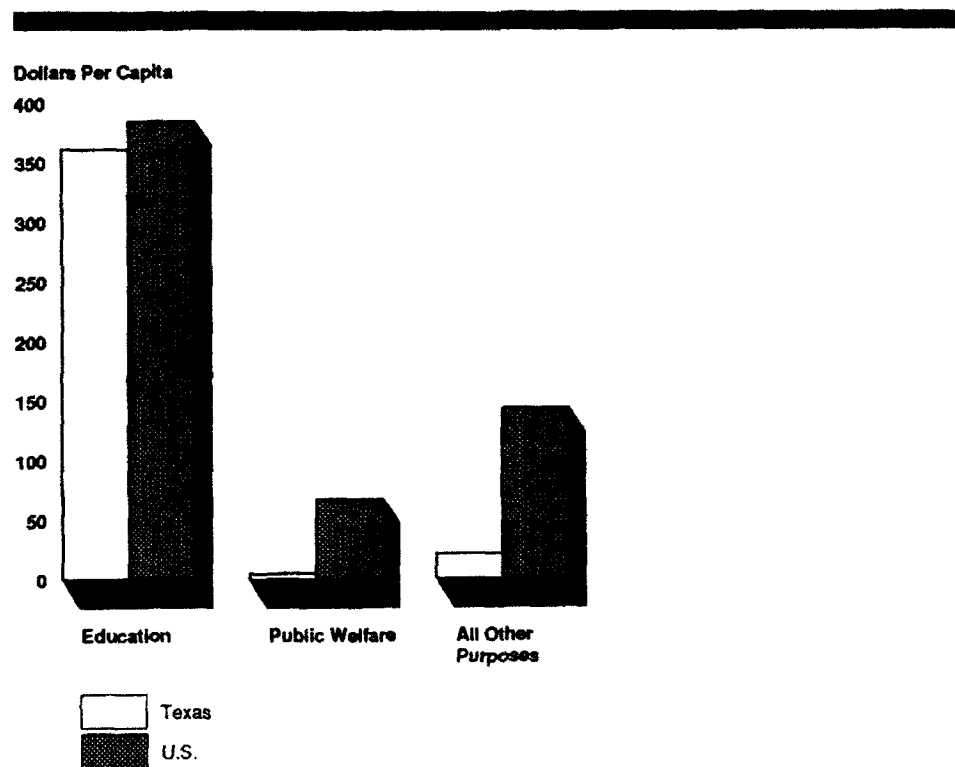
In recent years, state expenditure policies have been altered by laws or court decisions, particularly in areas that affect counties. The impacts are most apparent in the areas of education, prison, and health care. For example:

- The state now limits the size of kindergarten through 4th grade classes to no more than 22 students per room. Yet, the state provided no aid to meet these costs, estimated at \$300 million, statewide, for the first 2 years this law was in effect.
- Passage in 1985 of the Indigent Health Care and Treatment Act mandated counties to provide health care services to the poor who are not eligible for Medicaid and do not reside in an area served by a public hospital or a hospital district. Counties must absorb all administrative costs of this program. The state does provide limited funds to operate county indigent health care programs, but only after these costs have exceeded 10 percent of a county's general fund tax levy. In 1989, counties spent \$21.5 million to implement this mandate.
- Texas counties have been adversely affected by overcrowding in state prisons. Certain operations of the Texas Department of Corrections (including prisoner overcrowding) have been declared unconstitutional. As a result the Texas Department of Corrections has been obliged among other things to reduce inmate populations. For example, an official of the Texas Association of Counties told us that crowded state prisons have forced counties to house about 12,000 state inmates at county expense, about \$40 per day per inmate. A 1989 state report quotes county sources as projecting that, statewide, county operating costs associated with these arrangements could reach \$95 million.

Localities Must Finance Public Services on Their Own

Passing on costs, such as those described above, is in keeping with the state's highly decentralized system of public service provision. In fiscal year 1988, states allocated an average of \$592 per capita in state-local aid. But Texas provided \$385—65 percent of this average. Of this aid, 94 percent was targeted to education and 1 percent to welfare, leaving 5 percent in state aid for all other functions.

Figure 2.2: Per Capita State Aid to All Local Governments, Texas and the United States (Fiscal Year 1988)

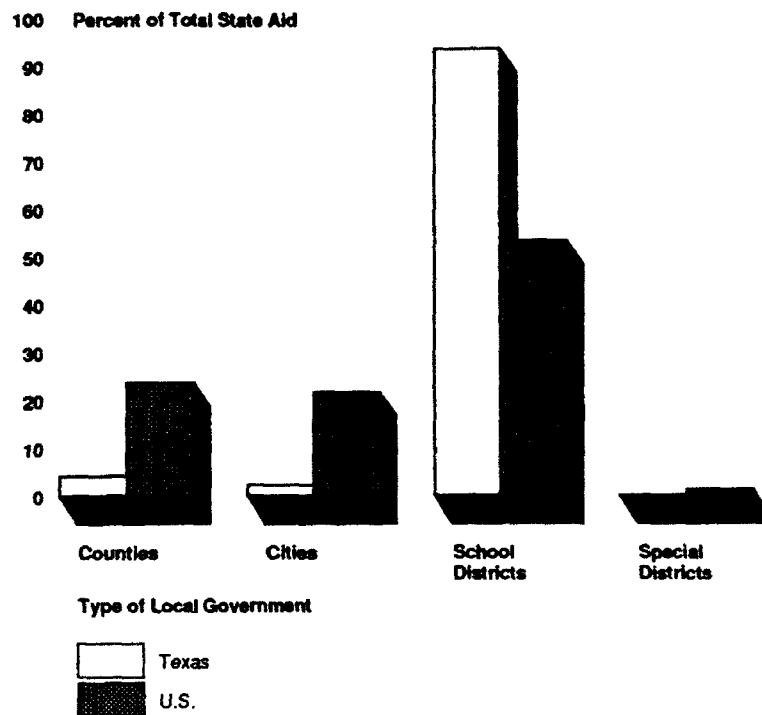


Source: Bureau of the Census

State aid patterns place heavy financing responsibilities on Texas counties and municipalities, for they deliver nearly all basic public services. The share of these services financed by the state is low relative to the national average, as figure 2.3 shows.

Chapter 2
Weak Economies and State Policies Strained
Local Finances and Capital Investment in
Poorer Texas Communities

Figure 2.3: Percent of State Aid to Local Governments, Texas and the United States (Fiscal Year 1988)

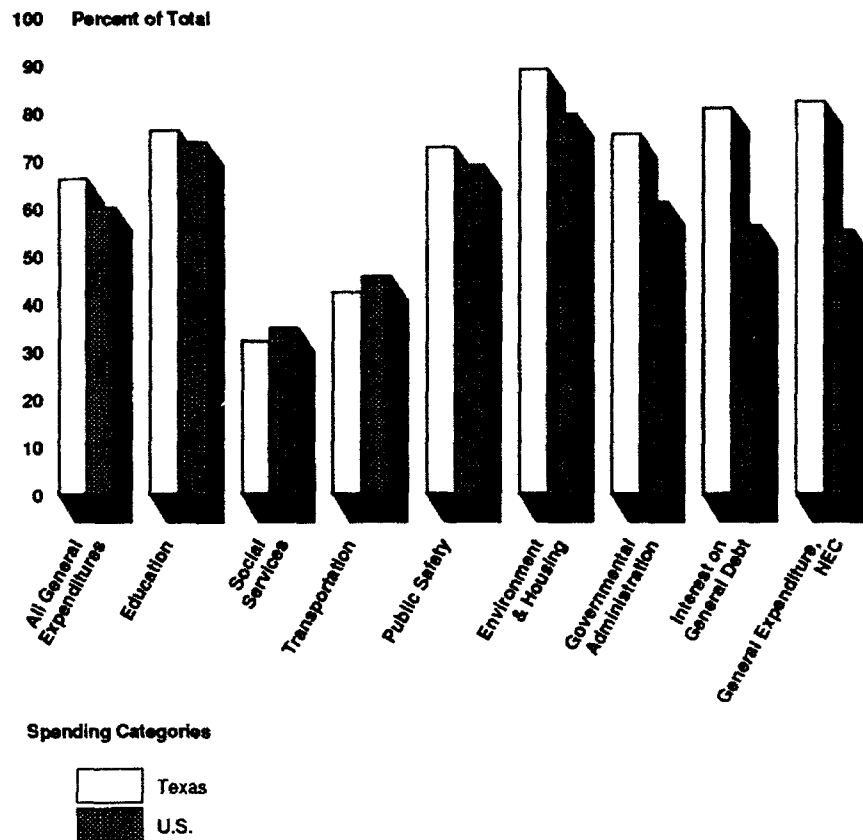


Note: Bar for U.S. cities includes townships in states where they exist.

Source: Bureau of the Census.

Overall, state aid patterns underscore the fact that local governments in Texas finance a consistently greater share of total state-local spending for most public services than others nationally. As figure 2.4 shows, these functions include education, public safety, environment and housing, and general administration.

Figure 2.4: Local Government Share of Total State and Local Spending, Texas and the United States (Fiscal Year 1988)

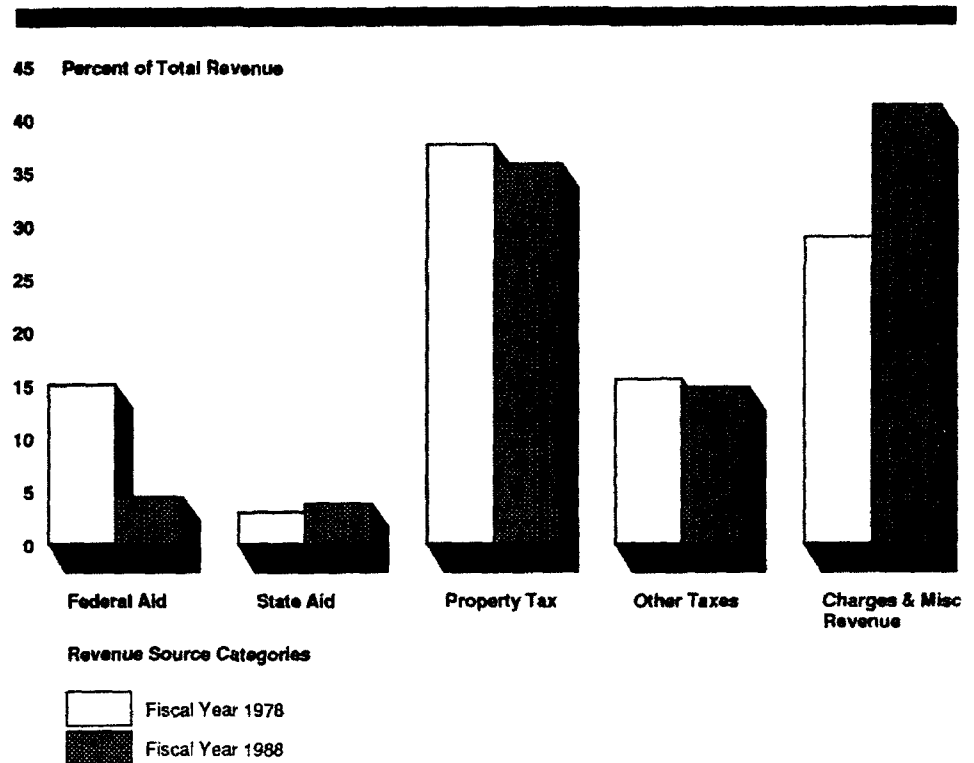


Note: NEC refers to expenditures not elsewhere classified
Source: Bureau of the Census.

Texas localities—including Weslaco and Uvalde—became even more self-reliant over the past decade with respect to state and federal aid. The diminishing role of state aid is evidenced in figure 2.5, which measures state aid in relation to local revenues among Texas counties and municipalities in 1978 and 1988. The figure also shows the extent to which federal aid declined during this period.

Chapter 2
Weak Economies and State Policies Strained
Local Finances and Capital Investment in
Poorer Texas Communities

Figure 2.5: Revenue Sources of Texas Counties and Municipalities as a Percentage of Total Revenues (Fiscal Years 1978-88)



Note: Excludes revenues from utilities, employee retirement systems, and insurance trust systems
Source: Bureau of the Census.

As the figure shows, there are two principal reasons for this trend. Between 1978 and 1988, federal aid dropped from 15 to 4.4 percent of total revenues. State aid failed to make up the difference, rising less than 1 percent over the 1978-88 period—from 3.0 to 3.8 percent.

Texas Gives Localities Taxing Authority Comparable to Most States

While Texas state aid is modest, local governments have access to an array of local tax sources that is comparable to that of localities in most other states,⁸ notably property taxes, general sales taxes, and some selective sales taxes. As is also true in most states, income taxes are not available to Texas localities.⁹

Not only is the range of taxes that may be levied by local governments in Texas similar to most other states, the limitations Texas places on local taxing authority are also comparable. In this respect, Texas administers local sales taxes and limits rates localities may impose (from 0.25 to 2.0 percent). The state also oversees local property tax appraisals and collections and dictates what property may be taxed by localities. Finally, the state imposes an upper limit on rates that local governments may apply and gives local voters opportunities to roll back tax rate increases of more than 8 percent.¹⁰ It is important to note that even if Texas gave localities greater freedom to diversify their tax bases and raise rates, poorer communities would still find it difficult to meet service needs from own-source revenues. As described more fully in chapter 1 (see p. 15), poorer communities have weaker tax bases and must make greater tax efforts than average communities to raise comparable amounts of revenue.

The Mismatch of Needs and Resources in Weslaco and Uvalde Make It Especially Hard to Provide Public Services

All Texas communities have had to wrestle with the fiscal consequences of a troubled economy, as well as increased costs of state-mandated programs and limited revenue raising options. However, poorer communities, such as Weslaco and Uvalde, face more difficulties than other localities in providing public services because they have greater needs, but fewer resources of their own.

⁸On the inadequacy of local tax structures to meet local revenue demands, see Frank Sturzl, "Municipal Expenditures in Texas," in *Rethinking Texas Taxes*, Final Report of the Select Committee on Tax Equity, Vol. 2, 1989, pp. 131-135.

⁹Only 10 states allow localities to collect income taxes, which are a substantial share of total local taxes.

¹⁰Communities have tended to limit their increases to below 8 percent to avoid possible rollback elections.

Weslaco and Uvalde Have Greater Service Needs, but Fewer Resources

While the gap between wealthier and poorer communities did not widen in Texas, fiscal disparities have been and remain substantial. In fact, Texas has some of the wealthiest and poorest counties in the nation—with PCPI ranging from \$4,313 in Starr County to \$36,153 in Loving County. While per capita income statewide was \$5,633 in 1978, it was \$3,074 and \$3,797 in Weslaco and Uvalde, respectively. These differentials were maintained over the period we examined. In 1987, per capita income was \$10,646 in the state, but \$6,802 in Uvalde and \$5,701 in Weslaco. As a result, Weslaco and Uvalde—as well as communities in similar circumstances—continued to bear disproportionate service and financing burdens relative to other communities in Texas.

The city of Weslaco (1988 population of 24,410) covers over 8 square miles in the southernmost tip of Texas (9 miles from the Mexican border) in the lower Rio Grande Valley. Hidalgo County—one of the poorest in the state—overlies Weslaco. Weslaco is known as a center of agricultural activity in the Rio Grande Valley because the Lower Rio Grande Valley Research and Experimental Center is located there. Nonetheless, the largest employers in Weslaco are the school district (1,400 employees) and two apparel manufacturers (1,200 employees). Uvalde County (1988 population of 24,530) lies about 90 miles west of San Antonio and comprises 1,564 square miles of “hill country” in southwest Texas. The largest single employers in this county are two agricultural food-processing plants. As would be expected, economic mainstays are agriculture and ranching—areas that employ the majority of county residents.

Socioeconomic and other indicators listed in table 2.2 show that Weslaco and Uvalde have higher service needs than the average Texas community, but fewer resources of their own.¹¹

¹¹Because public service needs are difficult, and sometimes impossible, to measure directly, researchers use socioeconomic indicators as proxy measures. Rationales for using proxies are both methodological and theoretical. Methodologically, proxies are selected because statistically they are significantly related to more direct but less easily measured indicators of service needs. Alternatively, proxies are sometimes selected based on what is known about local public services. For example, other factors being equal, a community of detached, single-family houses can be expected to consume fewer resources than a community of older, multifamily, multistory residences to attain similar levels of fire protection. Proxies are also selected based on arguments that the poor are less able to substitute private for publicly provided goods, including education, libraries, health, housing, and parks and recreation.

Chapter 2
Weak Economies and State Policies Strained
Local Finances and Capital Investment in
Poorer Texas Communities

Table 2.2: Selected Socioeconomic Indicators, Uvalde and Weslaco

Figures in percent unless otherwise noted

	Texas	Uvalde	Weslaco
Spanish origin, 1988	22.4	57.4	62.2 ^a
Non-English speaking	4.5	12.7	38.7
Persons below poverty level, 1979	14.7	28.4	36.6
Unemployment rate, 1987	8.4	10.1	18.0 ^b
Lacking high school diploma	37.4	55.6	60.9
Overcrowded housing	7.2	14.5	23.9
Housing without air conditioning	16.8	38.7	40.5
Violent crime rate, 1987 (per 100,000 population)	652.6	^c	764.4
Taxable property value per capita, 1988	\$38,819	\$21,288	\$13,502
Per capita income, 1988	\$10,646	\$6,802	\$5,701

Note: Data are for 1980, unless otherwise shown. Overcrowded housing is the percentage of occupied units with more than 1 person per room in 1980. Housing without air conditioning is expressed as a percentage year-round housing units in 1980.

^aWeslaco data are for 1980.

^bThe 1987 unemployment rate was not available for Weslaco. The rate shown is for Hildago, the overlying county.

^cData for rural counties of less than 25,000 population are not available.

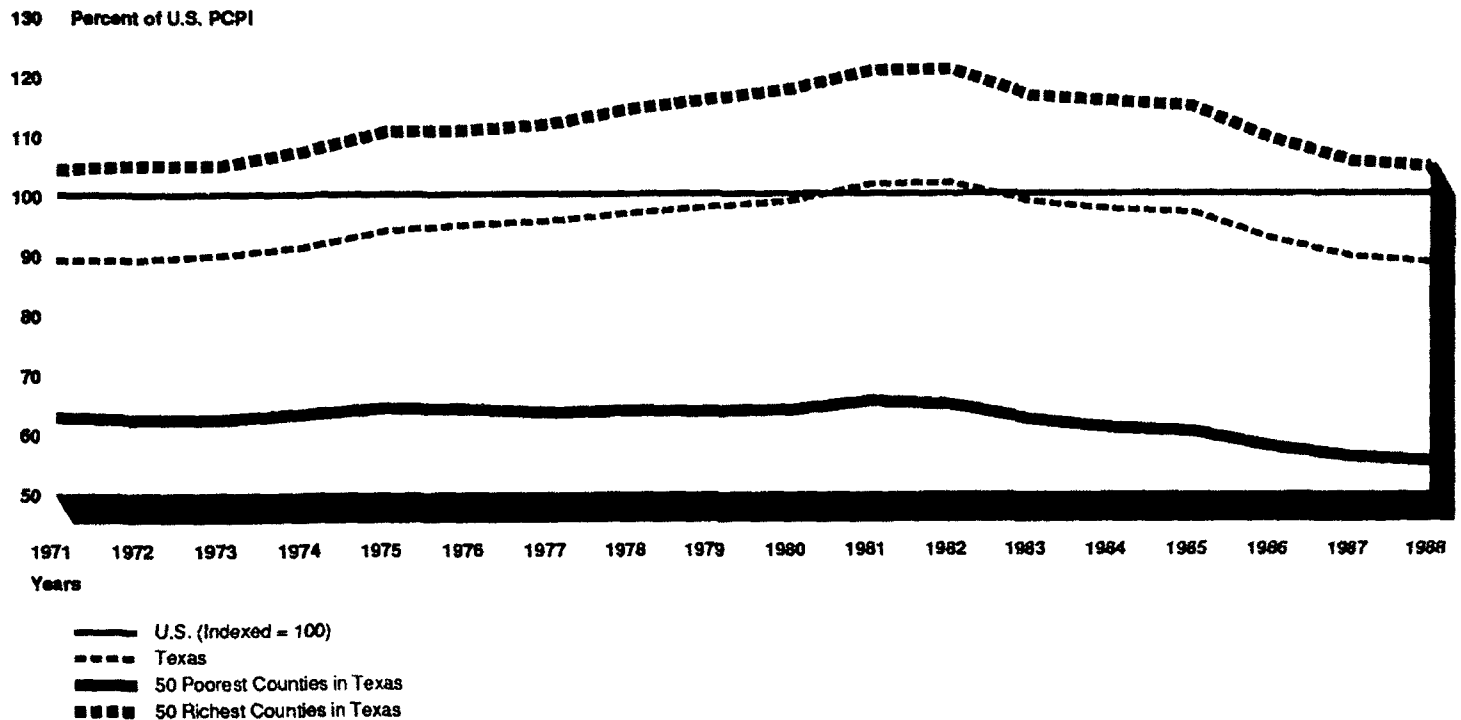
Sources: Bureau of the Census, Federal Bureau of Investigation, and state data.

Our analysis did not show that Weslaco and Uvalde were worse off in 1978 than they were in 1988, relative to state averages. Trends in Texas PCPI demonstrate this. On average, PCPIs in wealthier and poorer counties declined every year between 1981 and 1988 relative to the U.S. average, as figure 2.6 shows. As the figure also shows, the gap between wealthier and poorer counties in Texas did not widen during this period—in clear contrast to other states we studied¹² and the United States as a whole.¹³ In large part, this may be because all types of Texas communities—wealthy, middle-income, and poor—felt the impact of Texas's economic problems.

¹²Distressed Communities: Public Services Declined in New Jersey Despite Targeted State Aid (GAO/HRD-90-96, July 9, 1990) and Distressed Communities: Public Services Declined in California as Budget Pressures Mounted (GAO/HRD-90-95, Aug. 16, 1990).

¹³See figure 1.3, p. 16 of this report.

Figure 2.6: Trends in PCPI of Wealthier and Poorer Texas Counties as a Percentage of U.S. PCPI



Note: Top 50 and bottom 50 counties are averages of the 50 counties in each group.
Source: Bureau of Economic Analysis.

Revenue and Expenditure Trends Indicate Weslaco's and Uvalde's Problems

Local government revenue and expenditure data help to illustrate the consequences of concentrated demographic, social, and economic problems.¹⁴ Some statistics from Weslaco and Uvalde presented in table 2.3 illustrate lagging growth in local public services. These include, for example, the fact that total spending in Uvalde declined by 14 percent, while spending increased 53 percent for counties statewide. On the other hand, Weslaco's expenditure figures show increases in some categories of public service spending. It is important to note in this regard that Weslaco is in a game of service "catch-up" as it responds to demands associated with population growth that far exceeds the state (itself among the fastest growing of the 50 states). It is also important to note

¹⁴Service outputs (for example, the degree of police services provided) cannot be measured directly. Constant dollar expenditures per capita is a rough proxy for output because a wide variety of state and local policy and administrative actions change expenditures from year to year.

that Weslaco does not provide services comparable to the average Texas city, as measured by per capita spending. Where did Weslaco find the funds to finance these increases? As we describe in chapter 3, the city was forced to raise taxes, draw down its reserves until they were nearly exhausted, and vastly increase its debt.

Table 2.3: Expenditure and Revenue Trends for Selected Items, Weslaco and Uvalde Percent Changes in Constant Dollar Per Capita Amounts (Fiscal Year 1977 to 1987)

	Uvalde	All Texas counties	Weslaco	All Texas cities
Total general revenue	-28	49	94	35
Intergovernmental revenue:	-14	-12	448	-27
Federal aid	^a	-55	7	-45
State aid	^a	29	80	47
Total taxes:	-30	39	48	17
Property taxes	^a	39	^a	6
Total general expenditure	-14	53	97	38
Education	^b	2	^b	-83
Libraries	^a	24	^a	8
Public welfare	^b	15	^b	34
Health and hospital	302	9	499	-9
Highways	17	47	337	33
Police	9	65	95	30
Fire	^a	^a	108	22
Correction	13	154	^a	15
Sewerage and sanitation	^a	^a	120	65
Financial administration	^a	41	^a	48
Interest on debt	-100	705	113	184
Total debt outstanding	^a	364	183	74
Salaries and wages	2	23	101	7

Note: Constant 1982 dollar amounts calculated using implicit price deflator for state and local purchases of goods and services.

^aData unavailable due to changes in Census Bureau's reporting of items.

^bValue was zero in the earlier year.

Sources: Bureau of the Census and Bureau of Economic Analysis.

GRS an Important Funding Source for Capital Investments in Poorer Communities

As the Texas economy slackened, Uvalde and Weslaco used GRS for operation and maintenance activities, as well as capital improvements. As a result, the program's termination in 1986 did not directly cause spending on most basic services to decline from their already-low levels. However, the loss of GRS contributed to mounting budget pressures, reduced capital spending, and increased indebtedness.

Like most states, Texas does not have a program of general-purpose fiscal assistance targeted to its poorer communities. Such programs are not a solution to the demographic, social, or economic factors that underlie fiscal distress in poorer communities. Our past work, however, has shown that these programs can help. They can offset federal aid losses and help to lessen public service problems of poorer communities.

In its peak year, 1980, GRS provided \$224 million to Texas localities. Statewide, per capita revenue sharing averaged \$5.25 to counties and \$10.21 to cities in 1986. Poorer communities received relatively more. GRS provided \$18.96 per capita in aid to Weslaco and \$6.2 per capita to Uvalde. GRS funds comprised 6.2 percent of Weslaco's total revenues between 1982 and 1986, and averaged about \$467,000 annually. During this time, they comprised about 8 percent of Uvalde's total revenues, or \$190,000 annually.

How were these funds spent? Based on our interviews with local officials, it appears that the communities spent most of these funds for operation and maintenance activities involving public works. For example, we calculated that Weslaco used over 76 percent of GRS funds for capital projects, and Uvalde reported that about 89 percent of its total funds were used for operations and maintenance, principally the Road and Bridge Fund activities. However, beginning in 1984 and continuing for the next 2 years, a small share of revenue sharing monies were spent on local services in Uvalde County, including the operation of one health clinic, four fire departments, and three libraries.

Officials told us that while GRS was not a large part of their budgets, funds were significant because they helped to construct facilities and purchase capital equipment that otherwise would have been financially impossible to consider.

Actions Taken by Poorer Communities Helped Maintain Public Services, but Capital Investments Were Postponed

Texas did not take steps to offset the loss of GRS. Nor did the state take significant actions to reduce existing fiscal pressures associated with mandated services and locally depressed economies. Before and after the termination of GRS, Weslaco and Uvalde used three of four strategies described in chapter 1—improved administration, increased own-source revenues, and postponement of capital investments—to cope with their fiscal distress and the loss of \$467,000 annually in GRS funds in Weslaco and \$190,000 in Uvalde. As a result, both communities have been able to maintain most public services. Yet, Weslaco and Uvalde also have nearly eliminated their cash reserves, and—in the wake of the expiration of GRS—they have begun to delay needed capital projects.

Management Strategies Sometimes Helped to Maintain Services With Less Revenue

Weslaco and Uvalde acted to improve their administration and program operations to maintain services with less revenue. Notable strategies were administrative reorganization, efficiencies in service delivery, some increased reliance on private sector providers, and hiring and wage freezes. Both communities also drew down cash reserves, but this strategy is now exhausted for Uvalde.

Reorganizing Operations

In Weslaco, a senior accountant was hired to assist with long-range planning and budgeting, allowing the finance manager to focus on revenue and service problems. Weslaco also centralized its procurement functions. According to Weslaco's finance director, the city also enhanced its financial controls to reduce the costs of supplies. Uvalde consolidated some county functions. For example, the chief county administrative officer told us that the responsibilities of the county treasurer and auditor, Emergency Medical Services, and Indigent Health Care were folded into a single Department of County Finances. Juvenile and adult probation services were consolidated into a single Department of Community Services.

Increased Economy and Efficiency

Both communities tried to economize, but some efforts we studied fared better than others. For example, Weslaco changed its employee health care insurance contracts. City officials initially reported to us that this measure saved the city \$4,000 in 1988, and they projected savings of

\$250,000 in 1989. However, we were later informed that a 1989 automobile accident that killed one employee and injured two others eliminated any savings that may have accumulated.¹

In an attempt to reduce its contracting costs, Weslaco purchased a privately operated sanitary landfill. City officials were able to double the life of the landfill to 40 years. The initial savings were estimated at \$500,000 over a 7-year period. An added benefit from this effort was a recent agreement with two adjoining cities to participate in the landfill operation, providing Weslaco \$130,000 in additional annual income. This, in turn, is helping to offset the city's annual operating costs but may shorten the life of the landfill. The city also introduced a \$300,000 recycling program, financed over a 10-year period.

Uvalde discontinued its county-run emergency medical services. The operation was eliminated when the county joined a cooperative emergency medical services venture, mostly comprised of volunteers with reduced county funding.

Wage and Hiring Freezes

Hiring and salary freezes were other alternatives these local governments pursued to reduce spending over the past 5 years. For example, Uvalde county employees did not receive a pay increase between 1985 and 1989. Also a hiring freeze was imposed in 1986. Altogether, the county has laid off five employees since 1988. Moreover, while employee salaries increased by 5 percent in 1989, in 1990 they did not increase at all. Likewise, a Weslaco official reports that, although the city did not place a freeze on hiring, employee salaries have not kept pace with inflation. For example, in 1988 the city raised employee salaries by 7 percent, followed by no raise in 1989. Salaries were raised 2 percent in 1990.

Reserves Tapped

Weslaco and Uvalde drew on their reserves and fund balances to provide public services. Weslaco's general reserve funds declined between 1983 and 1990 to balance the budget. A 24-percent drop in cash reserves between 1986 and 1987 reduced reserves to about \$1,115,000. According to city officials, this decline in reserves was caused by a variety of factors, including the loss of GRS funds, the increased need for

¹Thereafter, in 1990, city officials attempted to renegotiate private insurance. However, a second claim for a heart transplant caused private insurance companies to cancel their bids. City officials told us that the city will be forced to draw on reserves to meet obligations from this claim.

services, and costly mandates, such as water and sanitary standards. Uvalde's cash reserves decreased substantially in 1983 because of unanticipated general fund expenditures. Thereafter, the county was able to build modest reserves until 1987, when these were drawn down to meet operating costs and the loss of GRS funds. According to an Uvalde County official, reserves were negligible by 1990.

Raising Revenues Was the Primary Strategy Used

Weslaco and Uvalde County also raised revenues—primarily by increasing tax rates. Weslaco increased user fees and debt in order to maintain public services.

As described in chapter 2, raising taxes is not without difficulties in Texas counties and municipalities. Most localities are limited by state policies that mandate public hearings and/or voter approval, restrict the kinds of taxes that may be imposed, or limit the size of these increases. These limitations notwithstanding, both Weslaco and Uvalde raised taxes before and after the termination of GRS to cope with their fiscal distress.

Weslaco increased property taxes annually between 1983 and 1988, but not in 1989 and 1990. The amounts of these rate increases, however, were held to below 3 percent because of possible political repercussions. In 1990, Weslaco officials obtained voter approval for an increase of 1 percent in Weslaco's sales tax rate to 2 percent.² Of this 1-percent increase, half was accompanied by a comparable reduction in property taxes. Its timing will allow a one-time windfall of \$650,000 in new revenues, as projected by city officials.³

Uvalde County raised property rates 3 percent in 1983, 6 percent in 1984, 8.6 percent in 1985, and 8 percent in 1986. In 1987, these rates were increased, by 23.26 percent—an 8-percent increase coupled with a 15.26-percent increase to finance the costs of state mandates related to indigent health care. There was no rate increase in 1988 and only a

²This increase was made possible in 1989 by state enabling legislation. Through this, the state gave cities in counties of less than 500,000 population and counties without a metropolitan transit authority a local option sales tax, whereby they could add as much as 1 percent to their existing sales tax rate. Cities were required to earmark 0.5 percent of this increment for industrial development activities. The purpose of the new optional sales tax is to reduce property taxes.

³"Windfalls" were created by the timing of tax actions. Local governments in Texas were permitted to impose sales tax increases before instituting property tax relief. Both Weslaco and Uvalde exercised this option, garnering sales tax revenues in the first year that were not offset by losses in property tax revenues. The following year, property tax relief actions were taken as required by state law, thereby eliminating any future such windfalls.

3-percent increase in 1989.⁴ However, in 1990 rates increased by 8 percent, the rate allowable without the possibility of a rollback election. Like Weslaco, Uvalde County also took advantage of state legislation enabling local governments to increase their sales taxes in January 1988. In so doing Uvalde collected almost \$220,000.

Weslaco also increased user fees. For example, city officials increased water, sewer, and brush pickup rates in 1987. Local officials reported that these increases produced about \$450,000 in new revenue by 1988.

Bond Debt Increased

In Texas, bond debt is a significant source of financing by state and local governments for major capital projects—such as buildings, water lines, or bridges.⁵ This implies that debt service is an important spending obligation. Bond indebtedness is a growing trend. According to Census Bureau data, in 1978 Texas ranked 25th among the states in total debt per capita, while in 1988 it ranked 18th.

Collectively, state and local government debt in 1988 has been estimated at between \$47.8 billion and \$59.3 billion. The Texas Municipal Advisory Council reported the first figure, citing that outstanding bond issues have been growing annually at an average of 18 percent between 1980 and 1988. The large increase is explained by heavy spending on infrastructure and other capital investments to meet rising service demands of an expanding population. Meanwhile, the Texas Research League cited the total debt as \$59.3 billion, or \$3,522 per capita, and reports that cities incurred the most debt,⁶ followed by special districts, counties, and school districts.

Like most cities in Texas, Weslaco turned to borrowing as a principal means to raise more revenue. As a result, city officials have thus far been able to meet community needs for sewers, streets, and airport facilities without large tax increases. Increasing debt enabled the city to

⁴If a rate increase is 3 percent or less there is no requirement to hold hearings. Also, if the increase is greater than 8 percent, voters are given the opportunity to petition for an election to roll back the increase to 8 percent.

⁵Debt financing of major capital projects, such as buildings and water lines, occurs for two principal reasons. In practical terms, high, up-front costs of these investments make borrowing the only means of financing them. Moreover, debt financing helps to spread project costs to taxpayers who will receive these benefits in the future.

⁶A 1988 Texas Municipal League survey found that cities have a real impending problem with their tremendous need for costly infrastructure improvements. They will need to spend massive amounts of money to address future needs.

expand services to meet the demands of its growing population. Weslaco's population jumped 28 percent between 1980 and 1988, outpacing the state increase by nearly 9 percent.⁷ In particular, Weslaco, between 1982 and 1988, issued about \$5.0 million in general obligation bonds and about \$9.5 million in revenue bonds.⁸ Consequently, debt servicing costs of the city's total fund expenditures increased by nearly 370 percent—from \$267,000 in 1982 to about \$1,256,000 in 1988.

Uvalde County has not incurred any new debt since the early 1960s, when general obligation bonds were used to support flood control and jail construction. According to county records, all existing debt was retired by the early 1980s. Yet, borrowing practices could change. County officials informed us that major road and bridge repairs are badly needed. Uvalde County commissioners are considering a \$3 million general obligation bond issue for these purposes.

Capital Investments Were Postponed

Weslaco and Uvalde used administration and revenue-raising strategies to cope with general fiscal stress and declining federal aid. These strategies have proven to be adequate in maintaining most public services at low levels. However, since the loss of GRS, city and county officials have postponed some needed capital projects. For example:

- In Weslaco, an official reports that 50 percent of the streets are in critical need of being resurfaced. If not resurfaced, they will have to be reconstructed. An estimated 28 miles of water lines need repair. Moreover, about 20 percent, or 20 miles, of the city sewer lines need repairs. He also said that postponement of improving this infrastructure could result in long-term costs of over \$1 million. These needs have been identified, but they are not matched with any available funding.
- The chief administrative officer for Uvalde County identified four capital projects that await available funding. The first project, estimated to cost \$350,000, consists of building five low water crossings to support traffic in the absence of bridges. The second project, estimated at \$750,000, involves renovating and adding to the county jail to bring it in compliance with state standards. Thirdly, the county wants to construct

⁷Based on population estimates of the Bureau of the Census. The Texas State Population Estimates and Projections Program estimates that Weslaco's population grew by 38 percent between 1980 and 1988, compared to an 18-percent increase statewide.

⁸General obligation bonds pledge the full faith and credit of the issuing government as security. With revenue bonds, only the revenues from a particular source are pledged to pay the interest and repay the principal to the lenders.

a nutritional center for the elderly—cost estimated at \$175,000. The last project involves paving 50 miles of roads at a cost of \$500,000.

Conclusions

Texas's weak economy, together with conservative state policies and local fiscal management, caused most of the problems we observed in Weslaco and Uvalde. The two communities did not appear to be worse off in 1988 than they were in 1978, relative to the average Texas locality. However, they began this period substantially behind economically, and the fiscal disparities between them and average communities in Texas remained large throughout the period we examined. The state did not act to offset the loss of federal aid to its localities, nor did it take other steps to lessen fiscal stress associated with its highly decentralized service delivery system and weakened local economies.

Therefore, Texas communities, such as Weslaco and Uvalde, have had to cope with their budget problems largely on their own. To cope with these conditions, both communities improved program administration and operations, but also found it necessary to draw down existing reserves. Moreover, Weslaco and Uvalde raised taxes and increased user fees, and Weslaco incurred substantial municipal debt to meet the needs of an expanding population. These strategies have thus far helped the two communities to maintain their existing levels of public services. But, Weslaco and Uvalde could not sustain capital spending when GRS funding lapsed. And they have postponed needed capital projects as a result.

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